Unwise Breakfast Talk or the

Perils of Price-Fixing

Small businesses can get into unfair trade practice trouble

By Mauricio R. Hernandez, Esq.

Years ago in a small Pacific Northwest town, the local gas station operators breakfasted regularly each week. Some would say, just good neighbors breaking bread as friendly competitors. However, each week, without fail, the four different branded gas dealers also reached *an understanding* somewhere between their pancakes and sausages about the price of regular unleaded in their town for that week.

Just about everyone agrees such agreements controlling the price of a good or a service in a given market are anti-competitive. But for the working-stiff consumer forced to pay the same going rate regardless of where she buys her gasoline, they are especially bad.

Some business people may think this is just fine. After all, if every business owner charges the same high prices, then every business owner benefits as the market is also upgraded for everyone.

Counting on Dumb Consumers

What is lost in this equation is that consumers are not dumb. As soon as word leaks out about "the going rate" in a locality, consumers make sure they shop elsewhere, away from the captive marketplace. In that Northwest town, sales declined as passing motorists opted to buy their fuel before or after and not during their visits there. As sales went down, the pricing agreements broke up. One station went out of business and the new buyer wanted nothing to do with the breakfast meetings or with the old arrangement.

For a local example, of selective shopping for fuel, look no further than the Carson Valley. Given the choice, is your pocket book better served buying gasoline in Minden-Gardnerville, Nevada or in South Lake Tahoe, California? While these price variations generally reflect supplier zone pricing variances, different fuel formulations, higher transportation costs and taxes *and not* marketplace price-fixing, it does highlight how over time, consumers notice and wisely choose more competitive marketplaces.

Most of the time, consumers complaining about unfair trade practices and price-fixing in particular, seldom think beyond the realm of gasoline prices. Perhaps it's because gasoline is so universally used and needed. Or perhaps, it's because the news media and the politicians love going after "Big Oil." Nevertheless, it's important to recognize that price-fixing can show up just about anywhere.

For instance, a few years ago, the Wisconsin Chiropractic Association (WCA) and its executive director, Russell A. Leonard, agreed to settle Federal Trade Commission (FTC) allegations that they orchestrated a conspiracy among WCA members to increase prices for chiropractic services and to boycott third-party payers to obtain higher reimbursement rates. The result, the FTC said, was higher prices for consumers of chiropractic services. The proposed settlement prohibited the WCA and Leonard from fixing prices for any chiropractic goods or services, or the terms of third-party payer contracts.

Government Regulation and Enforcement

Many business owners think federal and state trade practice and antitrust laws apply only to the likes of big corporations not the corner gas owner, doctor, hay seller or horse shoer. Not so, our economy runs on small businesses. Indeed, more likely than not, especially in rural communities, many of us most often trade with small businesses.

Antitrust and unfair trade practice laws reflect the value society places on free competition. Agreements that restrain trade, including price-fixing or divvying up customers by area are plain illegal. And because it is readily the most obvious, pricing is one of the most significant unfair trade practice issues.

Having breakfast or a beer after work with competitors is fine. But remember the standard of proving collusive agreements is not very high. Don't have any 'wink-wink' conversations about holding the line on price reductions or on where the level of pricing should be for your good or service. Merely exchanging price or cost information may be sufficient to get everybody into trouble.

One of the earliest trade laws, the Sherman Antitrust Act, dates back to 1890 and was intended to promote competition in the marketplace. In particular, the Sherman Act prohibits any agreement among sellers that restrains free trade in the marketplace.

Practices that come under the antitrust laws are classified as horizontal or vertical. Vertical practices refer to such things as exclusive dealings between supplier and user firms or the granting of exclusive territorial rights to sell a product or service. Horizontal practices involve activities in the same industry. Horizontal arrangements include such practices as predatory pricing, price fixing or bid rigging. Excessively low prices may be evidence of predatory pricing.

State of Nevada

In the State of Nevada, the Office of the Attorney General, the U.S. Department of Justice (DOJ), and the FTC oversee enforcement of state and federal antitrust laws. Chapter 598A of the Nevada Revised Statutes prohibits price fixing, division of markets, allocation of customer and tying arrangements. In Nevada, a person who conspires to, or does violate any of the provisions of the state's unfair trade practices laws can also be subject not only to civil penalties but criminal penalties, as such offenses are category D felonies. Under Chapter 193.130 of the Nevada Revised Statutes, a category D felony is a felony for which a court shall sentence a convicted person to imprisonment in the state prison for a minimum term of not less than 1 year and a maximum term of not more than 4 years. In addition to any other penalty, the court may impose a fine of not more than $5,000, unless a greater fine is authorized or required by statute.

Civil penalties include, at the suit of the attorney general, liability in an amount not to exceed 5 percent of the gross income realized by the sale of commodities or services sold by such persons in this state in each year in which the prohibited activities occurred. Furthermore, a domestic corporation or association failing to comply with a judgment or consent decree, may forfeit charter rights, privileges and powers as well as the privilege of conducting business in Nevada.

The FTC, which is both an antitrust and a consumer protection agency, learns of potential violations of the Federal Trade Commission Act in two principal ways. The first is through its own investigations but the second and most common way is via complaints of competitors and consumers.

Department of Justice

The U.S. Department of Justice publishes informational bulletins to educate the public about antitrust problems and about price-fixing in particular. One such bulletin talks about collusion, which it says is more likely to occur when industry conditions are already favorable to collusion. In the DOJ bulletin, *Price Fixing, Bid Rigging, and Market Allocation, What They Are and What to Look For, An Antitrust Primer,* it states,

- *Collusion is more likely to occur if there are few sellers. The fewer the number of sellers, the easier it is for them to get together and agree on prices, bids, customers, or territories. Collusion may also occur when the number of firms is fairly large, but there is a small group of major sellers and the rest are "fringe" sellers who control only a small fraction of the market.*
- *The more standardized a product is, the easier it is for competing firms to reach agreement on a common price structure. It is much harder to agree on other forms of competition, such as design, features, quality, or service.*
- *Collusion is more likely if the competitors know each other well through social connections, trade associations, legitimate business contacts, or shifting employment from one company to another.*

Regardless of industry, it seems the temptation is always there. In the equine or horse business, every now and then, the suspicion arises. When hay prices go up and they seem to go up everywhere or when the price of shoeing a horse appears to be the same everywhere, some equine owners wonder. No one is immune. Many of the most recent FTC enforcement cases involve physicians and health care networks. Even lawyers can be susceptible. Not long ago, a law firm mailed me a new associate announcement. However, along with their new staff addition notice, they included a "new fee schedule" listing all of the rates from top lawyer to legal assistant. I wondered, "why?"

Price-fixing agreements show up in different ways. The FTC especially looks out for agreements to: hold firm on prices; adhere to minimum fee schedules; not to advertise prices; adopt a standard formula for computing prices; establish or stick by certain price discounts; fix credit terms; maintain certain price differentials between types, sizes, or quantities; and police the agreements to make sure everyone toes the line. Not always but sometimes, identical prices by themselves may indicate signs of a price-fixing conspiracy. This is especially true when such identical prices were previously different and now stay high for a long period, particularly when the increases don't appear to be supported by higher costs.

Price Hikes Show the Way

A January 1997 editorial in *Anvil Magazine,* a farrier trade publication, underscored how the area dictates the price of shoeing a horse. In the same editorial, entitled "That Dreaded Price Hike," author and farrier Chris Gregory went on to say, "price hikes don't have a negative effect on business unless you were the low guy on the totem pole." Gregory argued in favor of boosting farrier fees. In other words, Gregory reasoned that once you compete solely on lowest price, it is self-defeating. Price-conscious shoppers will disloyally leave you if you ever raise your prices although he says, "this is really a good thing, however, because these people usually don't have the best of horses."

Aside from the incredibly bad form of insulting your clientele or offending the sensitivities of your four-legged customers, such short-sighted statements overlook consumers willing to pay higher prices when given a justified difference in value. Absent such value differentiation, traders in commodities (economic goods freely exchangeable and indistinguishable from one another, such as gasoline, produce, or timber), often have little to support a consumer's buying decision except for price.

Similarly, some observers believe that even services can be commoditized, especially if they are indistinguishable from one provider to the next. Unless a business service person can persuasively tell a story about service quality, established reputation, long experience, better training, unique certification, or superior equipment, the average consumer may recognize no material difference among providers except for price. In the case of farriers, is one shoer the same as another save for price? Said another way, if all shoers charge the same price, what then, is the difference among them?

If all gasoline is essentially the same, why pay 10 or 15 cents more for one brand over another? Why pay one penny more? If all gasoline stations charge the same gas price, what then, is the difference among them?

Collusion, the nature of business

Given the vigorousness of price-fixing and bid-rigging cases prosecuted by the Department of Justice, one can understandably conclude that businesses will collude whenever possible. Certainly, in the case of oil companies, many a politician and state attorney general has pandered to the worst suspicions of consumers by opportunely waving price-fixing accusations whenever there is a run-up in gasoline prices. The calls for investigations are as predictable as local television camera crews outside post offices on April 15th.

In this view, antitrust supervision is essential. Other perhaps more cynical regulators and free-marketers borrow from the old axiom of "no honor among thieves" and believe little or no such supervision is necessary because historically, price-fixing alliance arrangements break down as a result of cheating by their own members. While such cheating is difficult to detect because of the secretiveness of the wrongdoers, hush-hush price discounts generally undermine the arrangements.

Experienced Help

If proven, antitrust violations may result in triple damages at the federal level and as discussed above, equally harsh consequences for Nevada violators. The best advice to small businesses is to avoid such highly expensive problems by remaining mindful of unfair trade practices in your day-to-day business conduct. Don't think for a moment that anti-competitive agreements are only problems of big business. Somewhere between price and that last wink over your final cup of coffee, danger lurks.

Attorney Mauricio Hernandez is a horse owner and trail rider in general civil practice in Northern Nevada. His emphases are business, employment and personal injury law. He is licensed in Nevada and Arizona and has counseled trainers and horse owners. He can be reached at mo@lawmrh.com or (775) 782-0195. The information provided is not intended as legal advice specific to your situation but merely general information related to general legal issues. Consult with an attorney licensed in your state, if you desire specific legal advice.

Mauricio R. Hernandez
Attorney at Law